

**REPORT OF THE AUDITOR-GENERAL TO THE MPUMALANGA LEGISLATURE AND
THE COUNCIL ON THE FINANCIAL STATEMENTS AND PERFORMANCE
INFORMATION OF THE THEMBSILE HANI LOCAL MUNICIPALITY FOR THE YEAR
ENDED 30 JUNE 2009**

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I was engaged to audit the accompanying financial statements of the Thembisile Hani Local Municipality which comprise the balance sheet as at 30 June 2009, and the income statement, the statement of changes in net assets and the cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes, as set out on pages XX to XX.

The accounting officer's responsibility for the financial statements

2. The accounting officer is responsible for the preparation of these financial statements in accordance with the entity-specific basis of accounting, as set out in accounting policy note 1 and in the manner required by the Local Government: Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA) and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

The Auditor-General's responsibility

3. As required by section 188 of the Constitution of the Republic of South Africa, 1996 read with section 4 of the Public Audit Act, 2004 (Act No. 25 of 2004) (PAA), my responsibility is to express an opinion on the financial statements based on conducting the audit in accordance with the International Standards on Auditing and *General Notice 616 of 2008*, issued in *Government Gazette No. 31057 of 15 May 2008*. Because of the matters described in the Basis for disclaimer of opinion paragraphs, however, I was not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

Basis for disclaimer of opinion

Accumulated funds

4. The opening balance of accumulated funds as disclosed in the balance sheet as well as the corresponding figure for accumulated funds was reduced by R11 672 472. Management could not provide reasons and/or supporting documentation for such a reduction. The following were therefore understated by the amounts indicated:
 - Accumulated funds as at 30 June 2008 and 30 June 2009 by R11 672 472
 - Provision for bad debts by R1 964 131
 - Income contribution by R1 089 662
 - Salaries by R8 232 726
 - Water deposit by R379 034
 - Housing allowance by R6 918

Income

5. Interest from external investments was overstated by R1 920 530, due to an unexplained difference between interest earned per the bank confirmation certificates and interest received and disclosed in note 14 to the financial statements. Had the correct amount

been disclosed, interest received, bank and cash as well as the accumulated funds would have been reduced by R1 920 530.

6. I could not obtain sufficient appropriate audit evidence nor did the municipality's records permit the performance of alternative audit procedures to obtain reasonable assurance as to the occurrence, completeness and accuracy of rental income disclosed in the income statement amounting to R123 364, as a detailed listing/register of houses owned by the municipality and rented out could not be provided.

Debtors

7. I could not obtain sufficient appropriate audit evidence nor did the municipality's records permit the performance of alternative audit procedures to obtain reasonable assurance as to the existence, rights, completeness, valuation and allocation of debtors to the value of R20 678 847 as disclosed in the balance sheet, as a detailed listing/ledger could not be provided.
8. Furthermore, debtors with credit balances amounting to R9 947 547 were incorrectly netted off against debtors instead of being recorded as creditors. Had the correct disclosure been made, debtors would have increased by R9 947 547 and creditors increased by the same amount.

Salaries and allowances

9. There was an unexplained difference of R8 273 528 between salaries as recorded in the income statement and the ledger as per the Munsoft salary system. Therefore, salaries and allowances were understated by R8 273 528 and cash and bank overstated by the same amount.
10. Councillor's allowances disclosed in the income statement amounting to R10 639 085 were incorrectly allocated to general expenditure. Had this been correctly allocated, salaries would have increased by R10 639 085 and general expenditure decreased by the same amount.

Irregular expenditure

11. The supply chain management regulations 12, 16 and 17 require that for values between R10 000 and R200 000 (VAT included), at least three written quotations should be obtained. The municipality did not obtain written quotations for transactions totalling R437 948 falling within the range prescribed above. This constituted irregular expenditure and the municipality did not disclose it as such in the financial statements, as required by section 125(2)(d)(i) of the MFMA.

Expenditure

12. Original supplier invoices (payment vouchers), quotations, tender documentation and bid evaluations could not be obtained for general expenditure amounting to R23 055 778 disclosed in the income statement. Therefore, I could not obtain sufficient appropriate audit evidence nor did the municipality's records permit the performance of alternative audit procedures to obtain reasonable assurance as to the occurrence, completeness and accuracy of the general expenditure to the amount of R86 716 471 as disclosed in the income statement.

Creditors

13. I could not obtain sufficient appropriate audit evidence nor did the municipality's records permit the performance of alternative audit procedures to obtain reasonable assurance as to the existence, obligations, completeness, valuation and allocation of sundry

creditors amounting to R890 928 as disclosed in note 9 to the financial statements, as the creditors listing or ledger could not be provided.

14. I could not obtain sufficient appropriate audit evidence to obtain reasonable assurance as to the existence, obligations, completeness, valuation and allocation of retention moneys amounting to R9 793 488 as disclosed in note 9 to the financial statements, as payment certificates could not be submitted. The municipality's records did not permit the application of alternative audit procedures.
15. Furthermore, creditors as disclosed in the balance sheet were understated by R3 915 515 as a result of invoices within year-end that were not accrued. Had the accrual been done, creditors and expenditure would both have increased by R3 915 515.

Value-added tax

16. I could not obtain sufficient appropriate audit evidence to obtain reasonable assurance as to the completeness, existence, valuation, allocation as well as rights and obligations of the value-added tax (VAT) payable amounting to R9 273 250 disclosed in note 9 and the VAT receivable amounting to R23 729 165 disclosed in note 7 to the financial statements, as the VAT 201 returns for the whole year could not be submitted. The municipality's records did not permit the application of alternative audit procedures.

Fixed assets

17. Fixed assets amounting to R10 772 999 constructed by the district municipality were not included in the local municipality's fixed assets as disclosed in note 4 to the financial statements. Had the disclosure been made, fixed assets as well as loans redeemed and other capital receipts would have increased by R10 772 999.
18. There was an unexplained difference of R948 926 between the total assets per the fixed asset register and the fixed asset amount included in note 4 to the financial statements. I could therefore not obtain sufficient appropriate audit evidence nor did the municipality's records permit the performance of alternative audit procedures to obtain reasonable assurance as to the existence, rights, completeness, valuation and allocation of the fixed assets to the amount of R296 113 806 as disclosed in note 4 to the financial statements.
19. Original supplier invoices (payment vouchers) and a detailed ledger for additions to fixed assets amounting to R35 953 977 could not be submitted. I could therefore not obtain sufficient appropriate audit evidence nor did the municipality's records permit the performance of alternative audit procedures to obtain reasonable assurance as to the existence, valuation and rights of fixed assets purchased during the year amounting to R64 386 304 as disclosed in note 4 to the financial statements.

Cash and bank

20. I could not obtain sufficient appropriate audit evidence nor did the municipality's records permit the performance of alternative audit procedures to obtain reasonable assurance as to the valuation, completeness and existence of the cash and bank balance of R19 224 741 included in the balance sheet, as no supporting documentation and detailed listing of the various reconciling items totalling R435 720 572 as well as explanations could be provided.

Cash flow statement

21. I was unable to gain sufficient appropriate audit evidence as to the completeness and accuracy of the cash flow information, due to the numerous items contributing to the disclaimer of opinion that affected the items in the balance sheet and income statement.

Disclaimer of opinion

22. Because of the significance of the matters described in the Basis for disclaimer of opinion paragraphs, I have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, I do not express an opinion on these financial statements.

Emphasis of matter

I draw attention to the following matter on which I do not express a disclaimer of opinion:

Basis of accounting

23. The municipality's policy is to prepare financial statements on the entity-specific basis of accounting, as set out in accounting policy note 1.

Other matters

I draw attention to the following matters that relate to my responsibilities in the audit of the financial statements:

Material inconsistencies in other information included in the annual report

24. I have not obtained information included in the annual report and have not been able to identify any material inconsistencies with the financial statements.

Governance framework

25. The governance principles that impact the auditor's opinion on the financial statements are related to the responsibilities and practices exercised by the accounting officer and executive management and are reflected in the internal control deficiencies and key governance responsibilities addressed below:

Internal control deficiencies

26. Section 62(1)(c)(i) of the MFMA states that the accounting officer must ensure that the municipality has and maintains effective, efficient and transparent systems of financial and risk management and internal control. The table below depicts the root causes that gave rise to the deficiencies in the system of internal control, which led to the disclaimer of opinion. The root causes are categorised according to the five components of an effective system of internal control. In some instances deficiencies exist in more than one internal control component.

| Par. no. | Basis for disclaimer of opinion | CE | RA | CA | IC | M |
|-----------------|--|-----------|-----------|-----------|-----------|----------|
| 4 | Accumulated funds | 7 | 5 | 3 | 3 | 1 |
| 5 – 6 | Income | 7 | 5 | 3 | 3 | 1 |
| 7 – 8 | Debtors | 7 | 5 | 3 | 3 | 1 |
| 9 – 10 | Salaries and allowances | 7 | 5 | 3 | 3 | 1 |
| 11 | Irregular expenditure | 7 | 5 | 3 | 3 | 1 |
| 12 | Expenditure | 7 | 5 | 3 | 3 | 1 |
| 13 -15 | Creditors | 7 | 5 | 3 | 3 | 1 |
| 16 | Value-added tax | 7 | 5 | 3 | 3 | 1 |
| 17 – 19 | Fixed assets | 7 | 5 | 3 | 3 | 1 |
| 20 | Cash and bank | 7 | 5 | 3 | 3 | 1 |
| 21 | Cash flow statement | 7 | 5 | 3 | 3 | 1 |

27. The instability at leadership level due to resignations and suspensions led to inexperienced personnel acting in key management positions. Capacity constraints in the finance department and lack of supervision and monitoring further weakened the internal control system within the municipality.

| Legend | |
|---|---|
| CE = Control environment | |
| The organisational structure does not address areas of responsibility and lines of reporting to support effective control over financial reporting. | 1 |
| Management and staff are not assigned appropriate levels of authority and responsibility to facilitate control over financial reporting. | 2 |
| Human resource policies do not facilitate effective recruitment and training, disciplining and supervision of personnel. | 3 |
| Integrity and ethical values have not been developed and are not understood to set the standard for financial reporting. | 4 |
| The accounting officer/accounting authority does not exercise oversight responsibility over financial reporting and internal control. | 5 |
| Management's philosophy and operating style do not promote effective control over financial reporting. | 6 |
| The entity does not have individuals competent in financial reporting and related matters. | 7 |
| RA = Risk assessment | |
| Management has not specified financial reporting objectives to enable the identification of risks to reliable financial reporting. | 1 |
| The entity does not identify risks to the achievement of financial reporting objectives. | 2 |
| The entity does not analyse the likelihood and impact of the risks identified. | 3 |
| The entity does not determine a risk strategy/action plan to manage identified risks. | 4 |
| The potential for material misstatement due to fraud is not considered. | 5 |
| CA = Control activities | |
| There is inadequate segregation of duties to prevent fraudulent data and asset misappropriation. | 1 |
| General information technology controls have not been designed to maintain the integrity of the information system and the security of the data. | 2 |
| Manual or automated controls are not designed to ensure that the transactions have occurred, are authorised, and are completely and accurately processed. | 3 |
| Actions are not taken to address risks to the achievement of financial reporting objectives. | 4 |
| Control activities are not selected and developed to mitigate risks over financial reporting. | 5 |
| Policies and procedures related to financial reporting are not established and communicated. | 6 |
| Realistic targets are not set for financial performance measures, which are in turn not linked to an effective reward system. | 7 |
| IC = Information and communication | |
| Pertinent information is not identified and captured in a form and time frame to support financial reporting. | 1 |
| Information required to implement internal control is not available to personnel to enable internal control responsibilities. | 2 |
| Communications do not enable and support the understanding and execution of internal control processes and | 3 |

| | |
|--|---|
| responsibilities by personnel. | |
| M = Monitoring | |
| Ongoing monitoring and supervision are not undertaken to enable an assessment of the effectiveness of internal control over financial reporting. | 1 |
| Neither reviews by internal audit or the audit committee nor self-assessments are evident. | 2 |
| Internal control deficiencies are not identified and communicated in a timely manner to allow for corrective action to be taken. | 3 |

Key governance responsibilities

28. The MFMA tasks the accounting officer with a number of responsibilities concerning financial and risk management and internal control. Fundamental to achieving this is the implementation of key governance responsibilities, which I have assessed as follows:

| No. | Matter | Y | N |
|-----|---|---|---|
| | Clear trail of supporting documentation that is easily available and provided in a timely manner | | |
| 1. | No significant difficulties were experienced during the audit concerning delays or the availability of requested information. | | N |
| | Quality of financial statements and related management information | | |
| 2. | The financial statements were not subject to any material amendments resulting from the audit. | | N |
| 3. | The annual report was submitted for consideration prior to the tabling of the auditor's report. | | N |
| | Timeliness of financial statements and management information | | |
| 4. | The annual financial statements were submitted for auditing as per the legislated deadlines (section 126 of the MFMA). | | N |
| | Availability of key officials during audit | | |
| 5. | Key officials were available throughout the audit process. | | N |
| | Development and compliance with risk management, effective internal control and governance practices | | |
| 6. | Audit committee | | |
| | • The municipality had an audit committee in operation throughout the financial year. | Y | |
| | • The audit committee operates in accordance with approved, written terms of reference. | Y | |
| | • The audit committee substantially fulfilled its responsibilities for the year, as set out in section 166(2) of the MFMA. | | N |
| 7. | Internal audit | | |
| | • The municipality had an internal audit function in operation throughout the financial year. | N | |
| | • The internal audit function operates in terms of an approved internal audit plan. | | N |
| | • The internal audit function substantially fulfilled its responsibilities for the | | N |

| No. | Matter | Y | N |
|--|---|---|---|
| | year, as set out in section 165(2) of the MFMA. | | |
| 8. | There are no significant deficiencies in the design and implementation of internal control in respect of financial and risk management. | | N |
| 9. | There are no significant deficiencies in the design and implementation of internal control in respect of compliance with applicable laws and regulations. | | N |
| 10. | The information systems were appropriate to facilitate the preparation of the financial statements. | | N |
| 11. | A risk assessment was conducted on a regular basis and a risk management strategy, which includes a fraud prevention plan, is documented and used as set out in section 62(1)(c)(i) of the MFMA. | | N |
| 12. | Delegations of responsibility are in place, as set out in section 79 of the MFMA. | | N |
| Follow-up of audit findings | | | |
| 13. | The prior year audit findings have been substantially addressed. | Y | |
| 14. | SCOPA resolutions have been substantially implemented. | Y | |
| Issues relating to the reporting of performance information | | | |
| 15. | The information systems were appropriate to facilitate the preparation of a performance report that is accurate and complete. | | N |
| 16. | Adequate control processes and procedures are designed and implemented to ensure the accuracy and completeness of reported performance information. | | N |
| 17. | A strategic plan (IDP) was prepared and approved for the financial year under review for purposes of monitoring the performance in relation to the budget and delivery by the municipality against its mandate, predetermined objectives, outputs, indicators and targets (section 68 of the MFMA). | Y | |
| 18. | There is a functioning performance management system and performance bonuses are only paid after proper assessment and approval by those charged with governance. | | N |

29. Too much reliance was placed on the consultants who compiled the financial statements of the municipality without supervision by the municipality. Internal audit did not attend all audit committee meetings in order to add value to the governance processes. The effect of this was the further weakening of controls and processes within the municipality.

Investigations

30. An investigation is being conducted in terms of section 106(1) of the Local Government: Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA) into alleged irregularities at the municipality. The investigation was still ongoing at the reporting date.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

Report on performance information

31. I was engaged to review the performance information.

The accounting officer's responsibility for the performance information

32. In terms of section 121(3)(c) of the MFMA, the annual report of a municipality must include its annual performance report, prepared by the municipality in terms of section 46 of the MSA.

The Auditor-General's responsibility

33. I conducted my engagement in accordance with section 13 of the PAA, read with *General Notice 616 of 2008*, issued in *Government Gazette No. 31057 of 15 May 2008* and section 45 of the MSA.

34. In terms of the foregoing my engagement included performing procedures to obtain sufficient appropriate evidence about the performance information and related systems, processes and procedures. The procedures selected depend on the auditor's judgement.

35. I believe that the evidence I have obtained is sufficient and appropriate to provide a basis for the findings reported below.

Findings on performance information

Non-compliance with regulatory requirements

Content of integrated development plan

36. The integrated development plan of the municipality did not include the key performance indicators and performance targets of the current year, determined in terms of its performance management system, as required by sections 26(i) and 41(1)(b) of the MSA and regulation 12 of the Municipal Planning and Performance Management Regulations, 2001.

Internal auditing of performance measurements

37. The internal auditors of the municipality did not audit the performance measurements on a continuous basis and did not submit quarterly reports on the audits to the municipal manager and the performance audit committee.

No mid-year budget and performance assessments

38. The accounting officer of the municipality did not (by 25 January of each year) assess the performance of the municipality during the first half of the financial year, taking into account its service delivery performance during the first half of the financial year and the service delivery targets and performance indicators set in the service delivery and budget implementation plan, as required by section 72 of the MFMA.

Performance information not received in time

39. An assessment could not be performed of the reliability of the reported performance information, as set out on pages xx to xx of the annual report, since the information was not received in time for audit purposes.

APPRECIATION

40. The assistance rendered by the staff of the Thembisile Hani Local Municipality during the audit is sincerely appreciated.

Auditor-General.

Nelspruit

14 April 2010



Auditing to build public confidence